NO. 22118-A

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ANGELUS FUNERAL HOME,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

LEO BRANTON, JR.,
3450 Wilshire Boulevard
Suite 1107
Los Angeles, California 90005

WILLIAM B. MURRISH,
3175 West Sixth Street
Suite 203
Los Angeles, California 90005

Attorneys for Petitioner

NO. 22118-A

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ANGELUS FUNERAL HOME,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

LEO BRANTON, JR.,
3450 Wilshire Boulevard
Suite 1107
Los Angeles, California 90005

WILLIAM B. MURRISH,
3175 West Sixth Street
Suite 203
Los Angeles, California 90005

Attorneys for Petitioner

TOPICAL INDEX

TABLE OF AUTHORITIES

Statutes

Texts and Misc.

NO. 22118-A

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ANGELUS FUNERAL HOME,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF

JURISDICTION

The within petition is for review of a portion of a decision of the Tax Court of the United States holding monies received by petitioner as deposits under certain post-1961 "Pre-Need Funeral Agreements" to be taxable as income to petitioner upon receipt and not to be exempted as holdings in trust. The Tax Court also determined that all payments under earlier similar agreements in a slightly different form were trust holdings only and were not taxable as income to petitioner; respondent initially appealed from this but subsequently abandoned such appeal and that portion of the decision below has become final.

Jurisdiction in the Tax Court was founded on 26 U.S.C. §§ 7442 and 6213. Jurisdiction in this Court upon the within petition for review is founded on 26 U.S.C. §7482.

STATEMENT OF THE CASE

Petitioner sets forth below the facts of the case, based upon the Stipulation of Facts agreed to at the Tax Court hearing, and confirmed by that Court, and upon the oral and documentary evidence introduced at the said Tax Court hearing:

1. The petitioner, Angelus Funeral Home, is a California corporation, with its principal place of business at Los Angeles, California (T.R., Vol. I, 1/ p. 23, Stipulation of Facts, Par. 1).

2. For the taxable year ending December 31, 1954, through the year ending December 31, 1961, petitioner filed timely corporate income tax returns with the District Director of Internal Revenue, at Los Angeles, California (T.R., Vol. I, p. 23, Stipulation of Facts, Par. 2).

3. Petitioner's business consists principally of providing funeral and burial services (T.R., Vol. I, pp. 23, 24, Stipulation of Facts, Par. 7).

4. As a part of its business during the years 1959, 1960, and 1961, petitioner entered into written contracts with

---

1/ Signifying, Transcript of the Record, Volume I.

individuals, which said contracts were delineated as "Pre-Need Funeral Plan Agreements". Said Agreements provided in advance for the rendition of specified funeral services upon the death of the party contracting with Angelus (T. R., Vol. I, pp. 23, 24, Stipulation of Facts, Par. 8).

5. Petitioner has been writing similar funeral contracts since 1954 (T. R., Vol. I, pp. 23, 24, Stipulation of Facts, Par. 9).

6. As amounts were collected by petitioner on the contracts during 1959, 1960 and 1961, petitioner in its bookkeeping method would debit a special clearing account (a checking account at the Bank of America) on its books and credit a liability account designated as "Pre-Arranged Funeral Liability" (T. R., Vol. I, pp. 23, 24, Stipulation of Facts, Par. 10).

7. During the years 1959, 1960, and 1961, it was petitioner's normal practice to deposit amounts collected on the contracts in a special clearing (checking) account (T. R., Vol. I, pp. 23, 25, Stipulation of Facts, Par. 12).

8. Petitioner did not reflect the amounts collected on the contracts as income in the year the payments were received (T. R., Vol. I, pp. 23, 25, Stipulation of Facts, Par. 13).

9. Petitioner returned income from the contracts only when it was required to fulfill its contractual obligations, namely, to provide funeral and burial services upon the death of the particular individual (T. R., Vol. I, pp. 23, 25, Stipulation of Facts, Par. 14).

10. Petitioner would reflect the income on its books by

debiting the liability account delineated as "Pre-Arranged Funeral Liability", and crediting earned income (T.R., Vol. I, pp. 23, 25, Stipulation of Facts, Par. 15).

11. During the years 1959, 1960, and 1961, aside from the special clearing (checking) account, there were four savings accounts used in conjunction with the collections on the contracts (T.R., Vol. I, pp. 23, 25, Stipulation of Facts, Par. 16).

12. The savings accounts were designated as trustee accounts (T.R., Vol. I, pp. 23, 26, Stipulation of Facts, Par. 17).

13. The amounts originally deposited in the special clearing account were periodically transferred from said account into one of the four trustee savings accounts (T.R., Vol. I, pp. 23, 26, Stipulation of Facts, Par. 19).

14. The written contract utilized by petitioner up to approximately September, 1961, 2/ provided that all sums collected by Angelus under the contract shall be deposited in a bank, trust company, or savings and loan institution, and that Angelus shall not thereafter withdraw any sums unless there was proof of death of the contracting party presented to Angelus, at which time Angelus could apply the sums collected toward the cost of funeral services which Angelus had thereupon rendered (Petitioner's Tax Court Exhibit No. 10; Tax Court Finding of Fact, T.R., Vol. I, p. 31).

2/ These earlier agreements were all in the form expressed and represented by Petitioner's Exhibit No. 10; these agreements are hereinafter referred to as "pre-1961 agreements" or as the "pre-1961 agreement-form".

15. In approximately September, 1961, petitioner changed its form of contract, which said form had the same provisions as its earlier contract, with only one exception: The new contract [3/] provided that, in consideration of Angelus paying to the contracting party ten per cent (10%) of all of the sums paid in by said contracting party within each calendar year, Angelus was given the right to utilize the sums paid in for the limited purpose of the acquisition and/or development of real property or for making capital improvements in its then-existing mortuary facilities (Petitioner's Tax Court Exhibit 11; Testimony of Mr. Hill, Reporter's Transcript, p. 50, line 24 to p. 51, line 12).

16. During the months of September, October, November, and December of 1961, even though petitioner had the right under the contract to utilize the funds for certain limited purposes, petitioner did not, in fact, make any withdrawals of the funds for any purpose other than a transfer of funds to which petitioner had become entitled as a result of having performed services under the contracts (T. R., Vol. I, pp. 23, 26, Stipulation of Facts, Par. 23; Joint Tax Court Exhibit 9-I, Schedule IV).

17. At the end of the taxable years in question, 1959, 1960, and 1961, petitioner had on deposit in the trustee accounts a sum in excess of what was shown on its books as the amount of the Pre-Need Liability under its contracts (Joint Tax Court Exhibit

---

3/ The form for these later agreements is embodied in Petitioner's Exhibit No. 11; the form of these agreements is hereinafter referred to as "the 1961 agreement-form".

9-I, Schedule I).

18. At no time during the taxable years 1959, 1960, and 1961 did petitioner withdraw any funds from the trustee pre-need accounts other than funds to which petitioner had become entitled as the result of having performed services (Testimony of Mr. DeMatoff, Reporter's Transcript, p. 65, line 22 to p. 66, line 4).

19. Both of the contracts utilized by petitioner gave petitioner, in consideration of the collection and conservation of the funds, the right to the interest earned on the sums on deposit in the savings and loan institutions, and this income was reported in petitioner's tax returns (Petitioner's Tax Court Exhibits 10 and 11; T.R., Vol. I, pp. 23, 26, Stipulation of Facts, Par. 22).

20. Both of the contracts required that "all amounts paid . . . shall be held by Angelus in irrevocable trust" (Petitioner's Tax Court Exhibits 10 and 11).

The Tax Court Decision

The Commissioner of Internal Revenue had previously made a determination that all sums collected under the "Pre-Need" contracts for all years in question were taxable to taxpayer in the year received. It was from this determination, and the resulting deficiencies, that the taxpayer filed its petition in the Tax Court.

The Tax Court found that under the pre-September, 1961 form of contract, petitioner "was a true trustee" and had no right

to use the money paid in by the pre-need applicants (T. R., Vol. I, Tax Court Decision, pp. 28, 36). Its judgment in this regard was that none of said sums collected pursuant to said contract were taxable to petitioner upon their receipt. Petitioner in this Court does not complain concerning that part of the Court's opinion. The Commissioner on June 1, 1967 filed a Petition for Review from that part of the Tax Court's decision (T. R., Vol. I, General Docket p. 3) but subsequently filed its written abandonment of that appeal as is reflected by the Records of this Court (See the footnote appearing on the cover page of the Transcript of Record, Vol. I). That part of said judgment has now become final.

The Tax Court, however, reached a conclusion that the change in the form of the contract which petitioner began using in September, 1961, because it gave to Angelus the right to use the funds for the limited purposes set forth in the contract, and heretofore described, "destroyed" the trust arrangement between the parties and thus made the sums taxable as they were received by the taxpayer. It is from this portion of the Tax Court's decision that petitioner filed its Petition for Review (T. R. Vol. I, p. 52).

SPECIFICATION OF ERRORS RELIED UPON

Upon this petition for review petitioner contends:

(1) That the right of limited use of the funds received by petitioner under the 1961 agreement-forms did not destroy the trust relationship between petitioner and its applicants; and,

(2) That the payments received under the 1961 agreement-forms are not income to petitioner because petitioner did not have unrestricted and unfettered use of such funds, but had only a very limited use which was secondary to the benefit created for the beneficiaries of the trust.

ARGUMENT

I

THE PORTION OF THE JUDGMENT BELOW HOLDING ALL FUNDS RECEIVED UNDER THE PRE-1961 AGREEMENT-FORMS WERE HOLDINGS IN TRUST AND WERE NOT TAXABLE AS INCOME TO PETITIONER IS FINAL AND BINDING AS THE LAW OF THE CASE AND UNDER RES JUDICATA.

As related in the Statement of the Case the Tax Court unequivocally -- and rightly -- held that all payments paid petitioner under the pre-1961 agreement-forms (as embodied in Petitioner's Exhibit 10) constituted payments in trust only and were not taxable to petitioner upon receipt as income. By the express terms of all such agreements all of the deposits were required to be held by petitioner "in irrevocable trust" and were required to be deposited in a bank or savings and loan association account to be held and maintained therein (unless earlier withdrawn by the applicant) until the applicant's death. Upon the applicant's death (but then only if the applicant did not die outside of Los Angeles County where funeral services by petitioner would not be "practicable" and, in actual practice, only if the relatives of the applicant did not otherwise

request a transfer of the deposited funds to another funeral director to perform the funeral services) the petitioner was authorized and required to apply the deposited funds to furnishing a casket and funeral service reasonably appropriate to the amount of the applicant's funds on deposit at his death. 4/

Clearly these deposited funds were characterized by contingency, and were held in trust, and because of these circumstances were not taxable as income to petitioner at the time of their receipt. The Tax Court's decision to this effect is supported not only by its own two cited prior decisions in The Seven-Up Company v. C. I. R. (1950), 14 T. C. 965, acq. 1950-2 C. B. 4, and Broadcast Measurement Bureau, Inc. v. C. I. R. (1951), 16 T. C. 988, but is confirmed as well by this Court's decision in closely parallel premises in Portland Cremation Association v. C. I. R. (C. A. 9, 1929),

4/ The contingency that the applicant might withdraw any or all of his deposits at any time prior to death and the contingency that the relatives after death might request a transfer of the funds to another funeral director to perform the funeral arose not from the face of the agreements but from the uniform conduct and practice of petitioner, according to the uncontested testimony, to always honor any such requests (Rep. Tr. pp. 23-25). These consistent acts by petitioner limiting the scope of its interests and rights under the agreements are particularly controlling as to its powers because the agreements would in any event be construed most strictly against its interests and powers because originating under its authorship.

The agreements called only for small original deposits (Rep. Tr. p. 24, lines 1-3, and p. 22, lines 5-15) and for small, merely voluntary periodic payments thereafter "at the will of the depositor" (Rep. Tr. p. 31, line 17). The down payment called for in the sample introduced as Petr's Ex. 10 was $2.00, and the expected monthly payments thereunder were only to be $5.00. Additionally, the agreements specifically and particularly provided that petitioner should possess "[no] right to sue for or otherwise demand payment of any sum . . . which is not voluntarily paid" (See par. 3 of Petr's Ex. 11 and cf. par. 3 of Petr's Ex. 10; see also the testimony above as to the applicant's right even to withdraw sums already paid).

31 F. 2d 843, and by abundant additional authority as well. (See: Metairie Cemetery Association v. United States (C. A. 5, 1960), 282 F. 2d 225, 229-230; C. I. R. v. Cedar Park Cemetery Association (C. A. 7, 1950), 183 F. 2d 533, 556-557; c. f. Clinton Hotel Realty Corp. v. C. I. R. (C. A. 5, 1942), 128 F. 2d 968-970; C. I. R. v. Riss (C. A. 8, 1967), 374 F. 2d 161, 171-172; Harcum v. United States (E. D. Va., 1958), 164 F. Supp. 650, 651; Warren Service Corp. v. C. I. R. (C. A. 2, 1940), 110 F. 2d 723, 724-725; Mantell v. C. I. R. (1952), 17 T. C. 1143, 1148-1149.)

Moreover, as related in the Statement of the Case although the respondent Commissioner initially appealed from the portion of the Tax Court's judgment here concerned he subsequently abandoned and dismissed that appeal. In consequence, it is settled law that that portion of the decision and judgment below is now final and res judicata. (Alexander v. Cosden Pipe Line Co. (1934), 290 U. S. 484, 487; Bolles v. Outing Company (1899), 175 U. S. 262, 268; United States v. Hickey (1873), 17 Wall. 9; Gannon v. American Airlines, Inc. (C. A. 10, 1958), 251 F. 2d 476, 482.) By abandoning his appeal, the respondent "has acquiesced and become concluded by" the Tax Court's judgment in the respect here concerned and "cannot now be heard to complain". (Alexander v. Cosden Pipe Line Co., supra, at p. 487; Bolles v. Outing Company, supra, at p. 268.) By token of this, even were the judgment below otherwise debatable in any respect as to the pre-1961 deposit payments, that holding is fixed now as "res judicata" (Beneneson v. United States (C. A. 2, 1967), 385 F. 2d 26, 30 f. n. 7; Cochran v. M & M

Transportation Co. (C. A. 1, 1940), 110 F.2d 519, 523; 13 Cyc. Fed. Proc. 29-30) and as "the law of the case" (5 C. J. S. 666). That portion of the decision "is not before the appellate court for review" (Id., at p. 729).

II

THE MERE CHANGE INTRODUCED BY THE 1961 AGREEMENT-FORM PERMITTING INVESTMENT IN TRUST OF DEPOSIT MONIES IN MORTUARY IMPROVEMENTS OR REAL PROPERTY OF PETITIONER IN LIEU OF DEPOSIT ONLY IN BANKS DID NOT DESTROY THE TRUST CHARACTER OF SUCH DEPOSITS NOR MAKE THE SAME TAXABLE AS INCOME TO PETITIONER.

A. Upon Principle the Mere Grant of the Limited Investment Power as to Deposit Moneys Expressed in the 1961 Agreement-Forms Did Not Destroy the Trust Character of Moneys Placed on Deposit Thereunder Nor Make Such Deposits Taxable to Petitioner as Income.

It being established not merely in principle but by res judicata and as the law of the case that the deposits under the pre-1961 agreements were deposits in trust and characterized by contingency and not taxable as income to petitioner as and when received, the single change in the deposit agreements effected in September 1961 and uniformly expressed and reflected in the agreements thereafter (being in the words and form embodied in Petr's Ex. 11) could not and did not under law alter these consequences. The sole change introduced by the 1961 agreement-forms (Petr's

Ex. 11) was a grant to petitioner of a limited power as to deposited funds to invest the same in trust in "any capital improvement to then existing mortuary facilities belonging to ANGELUS" or in "the acquisition and improvement of real property" to be acquired, in lieu of being required to place such deposits solely in a bank or savings and loan association account (Petr's Ex. 11, par. 5). In return for such limited investment power petitioner agreed to pay a form of interest; as to each applicant petitioner agreed to pay such applicant each calendar year ten per cent of the amount paid in as a deposit by such applicant in such calendar year (Id., par. 6). Under the new agreement-form, as before, petitioner was still required in explicit terms to hold all deposited moneys at all times "in irrevocable trust" (Id., par. 4).

Upon principle it is entirely plain that such limited power of investment, made as it was expressly subordinate to a mandatory command that like all other powers of the trustee it be exercised only "in irrevocable trust", could not and did not destroy the trust character of the deposit moneys paid under the new 1961 agreement-form. By its very terms it was not a personal power or a power in fee, 5/ nor a power to appropriate property, but a limited, regularable

---

5/ The Tax Court's citation of this Court's decision in Mutual Telephone Co. v. United States (C. A. 9, 1953), 204 F. 2d 160, confirms the point made here. The permitted user of funds by the taxpayer involved there (deposit in taxpayer's employee pension fund) was a user in fee (albeit a limited one, as deposit could only be to the pension fund); had the permitted user involved there required only a continued deposit in abeyance, or in trust, as at bar, it is plain that in such event the ruling there would have been that taxable income had not accrued.

power in trust only. And not only was it so limited and constricted by its terms but at bar there could be no possible contention that it had been given a broader scope or sanction by the practice or conduct of the parties for by joint stipulation it was established below that petitioner had never in fact asserted the power or undertaken to exercise it in any way, shape or form (Stipulation of Facts, pars. 23 and 24, R. T. 26; Joint Tax Court Ex. 9-I, Schedule IV; see also the Tax Court's statement that "petitioner had not in fact acted under [such] option ... at any time during 1961", as appears in T. R. 43 and in the reported opinion of the Tax Court, 47 T. C. 391, 398).

The Tax Court in holding against the petitioner fundamentally misconceived the limited, judicially-accountable trust character and scope of the investment power granted under the 1961 agreement-form. Asserting that such power authorized petitioner to invest deposited funds in "[the] acquisition and improvement of land . . . of sole benefit to the petitioner", the Tax Court erroneously characterized the nature of the granted power and the consequence of an exercise of it as follows:

> "It is patent that the title to such improvements and to such land would be in petitioner the same as title to any other of petitioner's properties, and that the values attaching thereto would be properly carried as an asset on petitioner's balance sheets and subject to claims of petitioner's general creditors. Such funds therefore would have lost all character of trust funds and all that

[would remain] would be a unilateral contractual obligation for petitioner to perform, or have performed, the funeral at applicant's death. . . . [In consequence, the moneys paid as deposits] were fully taxable to petitioner as they were received." (Opinion below, 47 T. C. 391, 398-399; T.R., Vol. I, pp. 42-44.)

The error of the Tax Court here is twofold.

Firstly, because the power to invest as expressed in the 1961 agreement-form was, like all other powers therein granted, made subject to an overriding, explicit command that it be exercised at all times "in irrevocable trust" only, the Tax Court errs in asserting that the granted investment power would or could be read in law to permit petitioner to invest the moneys deposited under the agreement-form in real property or improvements in petitioner's name alone and without placing upon the public record the rights and interests of the trust. The truth is that under California equitable law, which is the law which would control, trusts are apprehended and enforced jealously and with a liberal and protective regard for the interests and rights of beneficiaries. (4 Witkin, Summary of California Law, pp. 2890-2891; Coberly v. Superior Court (1965), 231 Cal. App. 2d 685; Estate of Miller (1964), 230 Cal. App. 2d 888; Estate of Moore (1961), 190 Cal. App. 2d 833; Estate of Cafferty (1966), 246 Cal. App. 2d 711.) If trust powers are abused or reasonable trust duties neglected, California makes available to any aggrieved beneficiary a formidable and effective

array of judicial remedies including proceedings to impose or declare equitable liens, to compel trust performance or to enjoin existing or threatened breaches, to compel an accounting and to remove and replace any misconducting trustee, if necessary, and for restitution or for compensatory or exemplary damages for any otherwise unredressed violations of duty. (4 Witkin, supra, pp. 2940-2942; Restatement of Trusts (2d) §§ 199 and 202; West v. Stainback (1952), 108 Cal. App. 2d 806, 815-816; Leitch v. Gay (1944), 64 Cal. App. 2d 16; St. James Church v. Superior Court (1955), 135 Cal. App. 2d 352, 357-362; Overell v. Overell (1926), 78 Cal. App. 251; Purdy v. Johnson (1917), 174 Cal. 521; Coberly v. Superior Court, supra; California Civil Code, §§ 863, 2251, 3422, 2283, 2237 and 2238; 31 Cal. Jur. 2d 240-242; 49 Cal. Jur. 2d 146-147 and 158.) Under California trust law the limited investment power here concerned would almost surely be read to require of petitioner that should it invest any of the trust moneys in any lands or improvements owned or acquired by it, it carefully segregate and account for any rights and interests thus established in the trust and that it place such rights and interests promptly on the public record. That is, petitioner could not hold any such lands or improvements simply in its own name alone, but would be required to vest the title to such properties pro tanto in the name of the trust, or of petitioner as trustee therefor.

Secondly, and beyond any doubt, no matter in what form or name title to any affected property or properties might be permitted or suffered to be held, if in truth and in fact any trust moneys

under the 1961 agreement-forms should be incorporated by petitioner into any lands or improvements, it is of the very essence of the trust character of such deposit moneys as defined and established under such agreements, that the applicant-depositors as trust beneficiaries could trace and reclaim any affected funds and could claim ownership of or a lien upon any such affected lands or improvements by token of equitable rights good not only against petitioner as trustee but against "his creditors, and anyone else except a bona fide purchaser." In any premises wherein trust moneys are incorporated into any identifiable properties, whether with or without right by the trustee, the trust beneficiary is granted in se "priority over the general creditors of the trustee" whenever he can trace and identify his trust interests therein, regardless of the name or form of any holding of title, absent the intervention of a bona fide purchaser for value. (4 Witkin, supra, pp. 2941-2942; Restatement of Trusts (2d) §202 at p. 445; Gilbert v. Sleeper (1886), 71 Cal. 290, 293; 49 Cal. Jur. 2d 321, et seq.)

Another way to evaluate and weigh the trust character of the limited power of investment granted at bar is to compare it to a grant to a trustee of a plenary and total power to lend trust moneys to himself for any (unlimited) use or purpose. Surely the granted power at bar is a far lesser authority than a plenary authority to lend money to oneself for any use or purpose. Yet under well established trust law even a grant to a trustee of total power to lend trust moneys to himself is not destructive of the trust character of a genuine trust instrument or deed (Restatement of Trusts

(2d) §170, comment (t), p. 372; 4 Bogert, Trusts and Trustees (2d ed.) 497-498; Nossaman, Trust Administration and Taxation (2d ed.) 444, although it will call for "strict construction" of any such power and for stern judicial scrutiny and review of the exercise thereof and the imposition of any necessary safeguards to protect and secure the legitimate interests and rights of any affected beneficiaries. (Bogert, Hand Book of the Law of Trusts (4th ed.) 253; Restatement, supra, p. 372; Nossaman, supra, p. 444.) So far from freeing the trustee from trust answerability or limitations, the grant of a power to lend trust properties to himself (or of any other power otherwise creating conflicts of interest or opening opportunities for abuse) calls forth the protections of equity and requires per se that the trustee under such powers be held to the fullest good faith in every respect. In such premises a trustee will be deemed to "violate his duty to the beneficiary . . . if he acts in bad faith no matter how broad may be the provisions." (Restatement, supra, p. 372.) His every act will be reviewed with the closest scrutiny, and there will be imposed the requirement "of uberrima fides." (Nossaman, supra, p. 444).

B. Strong Precedents Upon Closely Parallel Trust Facts Confirm That the Deposits Under the 1961 Agreement-Forms Were Holdings in Trust and Were Not Taxable as Income to Petitioner.

Strong precedents in trust law confirm the trust and non-taxable character of the deposit moneys under the 1961 agreement-

form despite the limited power of investment granted thereunder. These decisions explicitly confirm that the mere circumstance that the 1961 agreements do not expressly require that trust funds, and any investments thereof, be segregated and held separate at all times from the general properties of the trustee, in word and form as well as in substance, is not a basis for denying the enforceable trust vitality of, and the non-taxable nature of, money deposits intended in truth and substance to be held in trust.

Primary among the authorities here in point is the decision of this Court in Portland Cremation Association v. C. I. R. (C. A. 9, 1929), 31 F.2d 843. In that decision this Court held that moneys deposited with the taxpayer mortuary subject to a substantive oral or "inferred" trust that the moneys be held and used solely for the permanent maintenance and care of cremation urns and niches, were entitled to the rights and protections of trust deposits and were not taxable as income to the mortuary-trustee, notwithstanding that (1) the portion of the sales price of urn sales to be deposited in the "maintenance fund" was not fixed in any recital in the deeds, nor in the representations oral or written made in accompanyment to such sales, but rather was fixed (first at 10% and later at 20%) only in and by resolutions passed by the mortuary's board of directors and stockholders (pp. 844-846), and notwithstanding, further, that (2) "The income from the maintenance fund was mingled with the other income of the [mortuary], and was expended for maintenance along with other funds of the [mortuary] and the income from the maintenance fund was . . . credited directly to

the profit and loss account of the corporation." (p. 844). 5a/ These adverse features had persuaded the Board of Tax Appeals (10 B. T. A. 65) that "inasmuch as the maintenance fund set apart by the petitioner was so free from outside constraint that the petitioner might borrow from it at will and limit its amount at will", the maintenance fund "constituted no more than a contractual obligation cognizable at common law [but] insufficient to create a trust either express or implied such as a court of equity would administer", and that in consequence, "all sums received by the petitioner were gross income." (Quoted in 31 F. 2d 843, at p. 845.)

Upon appeal this Court reversed, holding that the deposited moneys (as well as the income therefrom) were valid, substantive holdings in trust and were not taxable to the mortuary upon receipt as income. In language central to the decision there and of crucial import as well for the case at bar, this Court said there at page 846:

> "While the petitioner here may be said to have had control of the money which it had placed in the maintenance fund, diversion of that fund for corporation purposes or any purpose other than that designated by its promise to maintain the same . . . [could] be enjoined by a suit in equity as a violation of the trust agreement. The crucial question is, Did the petitioner's patrons possess the right to protect themselves

5a/ Additionally the trust res was at times mingled with the general funds and holdings of the mortuary, and on one occasion the mortuary made an avowed "loan" to itself of $20,000.00 from the trust res and concededly used such loan "for corporate purposes" (p. 844).

and demand the preservation of the fund which the petitioner had covenanted with them to maintain and by its resolution had set apart for maintenance? The question is by the authorities answered in the affirmative." (Emphasis added.)

This language, and, indeed, the decision there reached upon the basis and authority thereof, is of direct applicability to the character of the deposit moneys at bar as non-taxable, trust holdings. At bar precisely as in the Portland decision, "The crucial question is, Did the [deposit fund beneficiaries] possess the right to protect themselves and demand the preservation of the fund . . ." and here, as there, "That question is by the authorities answered in the affirmative." Accordingly, under the authority of that decision the deposit moneys at bar are trust holdings and are not taxable as income to the petitioner upon their receipt.

Similarly, upon the authority of the Portland decision, the Tax Court in Broadcast Measurement Bureau, Inc. v. C. I. R. (1951), 16 T. C. 988, supra, and The Seven-Up Company v. C. I. R. (1950), 14 T. C. 965, supra, expressly held that certain deposits received in each case pursuant to trust undertakings were entitled to recognition as enforceable trusts, and were therefore not taxable as income to the affected taxpayer-trustee in each case, notwithstanding that there was a failure by the taxpayer in each instance to segregate the trust deposits from other receipts and holdings.

In the Broadcast Measurement Bureau case, the Tax Court,

at pages 1000-1001, aptly observed:

> "It may be argued that the [deposits] did not constitute trust holdings due to the fact that these funds were never segregated into separate bank accounts from sales receipts received [by the petitioner], loans received by the petitioner, and receipts from subscriptions to later studies. But such a comingling of the [deposited trust moneys] with other receipts does not destroy the identity of a trust fund. Seven-Up Co., 14 T. C. 965. Petitioner's books show the total amount of such fees it received and the unexpended balance thereof at all times. Any improper use of the unexpended balance of these fees by their custodian [i. e. the taxpayer-trustee] could have been enjoined by the [trust beneficiaries] by a suit in equity. Portland Cremation Association v. Commissioner, 31 F. 2d 843."

To like effect, and with like apt language upon facts closely parallel to those in the Broadcast Measurement Bureau case and closely parallel as well to those at bar, is the decision in The Seven-Up Company v. C. I. R., supra. The discussion expressed there at page 978 is in all respects parallel to the quotations excerpted above from the Portland Cremation Association and the

Broadcast Measurement Bureau cases.

C. Additionally, Important Precedents Arising In (a) Lease-Deposit Cases, (b) Executory Sales Contract Deposit Cases, and (c) Option Deposit Cases, Also Confirm the Non-Taxable Character of the Deposit Payments Paid to Petitioner and Held by it Under the 1961 Agreement-Form.

Further confirming the non-taxable character of the deposited moneys at bar are decisions in three analogous but non-trust areas of law. These deal, respectively, with (a) advance deposits paid by lessees to secure full performance of all lease covenants and, if not consumed so, thereafter to be applied by the lessor to satisfy the rent accruing for the last unit of the leasehold term; (b) advance deposits paid by the buyer in certain contingent, executory sales-contract cases where by the terms of the contract the deposits are to be applied against the sales price if a sale is ultimately consummated, but should a final sale not eventuate the deposits are to be accounted for and refunded by the seller to the buyer, and (c) deposits paid under certain option agreements whereunder the deposits accrue absolutely to the option-grantor (seller) should the option not be exercised but are required to be applied either in whole or some substantial part against the purchase price should the buyer elect to exercise the option.

These decisions separately and collectively, establish that even where deposit payments are concededly not held in trust by

the tax payer-receiver, but are avowedly usable by such receiver freely and without any restriction except subject to a contract duty to account therefor and to repay the same to the original payor should the period of or occasion for the deposit either fail or terminate, such deposits are to be treated as analogous to loans, and therefore as not constituting income, even though the holding does not even purport to be a holding in trust.

(a) Lease-Deposit Cases.

With respect to lease deposit cases creating precedents of persuasive and analogous authority for the issue at bar, a leading example is Clinton Hotel Realty Corp. v. C. I. R. (C. A. 5, 1942), 128 F.2d 968. There an advance deposit securing performance of the lease but at the end of the lease to be applied if(still available) as payment in satisfaction of the rent accruing for the last period of the lease term, was ruled to be during the interim period a "security deposit" only, or primarily, and therefore not taxable as income to the lessor. The Court summarized the law applicable to such dual-purpose, contingent-nature lease-deposit payments as follows at page 969:

> "[If the advance payment by the lessee] was paid and received as security, with no present right or claim of full ownership [by the lessor-recipient], it would not be presently income, although it was expected finally to be applied

in payment of the last year's rent if nothing happened to prevent that. Barker's Estate v. Commissioner, 13 B. T. A. 562; Warren Service Corp. v. Commissioner, 2 Cir., 110 F.2d 723. In the latter situation, though the money is rightfully received, and if the parties so intend may be freely used, yet because of the acknowledged liability to account for it, there is no gain; just as in borrowing there is none." (Emphasis added.)

At page 970 the Court further stated of the deposit concerned in the case before it for review:

"It was intended that lessor was not to hold it as a special deposit, but might use it as a general deposit, for he was to account for $1,000 per year as interest, in a credit against accruing rents. This does not destroy the character of the deposit as security, but the lessor's accountability for interest as well as for the principal emphasizes that character."

The emphasis upon the payment of interest by the depositholder in the Clinton Hotel decision has special relevance at bar since at bar petitioner expressly agreed to pay each year ten percent of the amounts deposited in such year as compensation for

its power to invest the deposit monies in mortuary real estate or improvements. Indeed, these payments were the very inducement which persuaded numerous applicants holding rights under the pre-1961 form of deposit agreements to cancel those agreements and substitute in their place new agreements in the new form entitling them to this measure of "interest" compensation [See T. R. 32; 47 T. C. at p. 393].

In accord with the Clinton Hotel decision both in reasoning and in holding see also such parallel and comparable cases as the follows: C. I. R. v. Riss (C. A. 8, 1967), 374 F.2d 161, 171-172; Zaconick v. McKee (C. A. 5, 1962), 310 F.2d 12, 15-16; Warren Service Corp. v. C. I. R. (C. A. 2, 1940), 110 F.2d 723, 724-725; Harcum v. United States (E. D. Va., 1958), 164 F. Supp. 650, 651 (stating in part, "The mere fact that the lessor is not required to hold the fund as a special deposit does not in itself destroy the character of the deposit as security [and so long as the deposit functions as security for the due performance of continuing and unexpired covenants, and does not operate and serve merely as an advance payment of rent] the amount received by the lessors is not taxable as income until [either a breach of covenant occurs entitling the lessor to forfeiture of the deposit] or until the last [rental period expires]"; Mantell v. C. I. R. (1952), 17 T. C. 1143, 1148-1149 (stating aptly, in part, "If, on the other hand, the sum was deposited to secure the lessee's performance under the lease, it is not taxable income even though the fund is deposited with the lessor instead of in escrow and the lessor has temporary

use of the money."); 2 Mertens, Law of Federal Income Taxation, §12.99, p. 365, and §12.30, pp. 158-159; 3 Rabkin and Johnson, Federal Income, Gift and Estate Taxation, §42.05, pp. 4214-4215, and §42.03, p. 4206; Annotation, 146 A. L. R. 995, 1001-1002.

(b) Executory Sales-Contract Deposit Cases.

Decisions confirming by parallel, persuasive authority the non-taxable character and nature of the deposit moneys at bar arise also, as heretofore indicated, in certain cases dealing with advance deposits paid by buyers in connection with contingent, executory sales-contracts whereunder the deposits are required in terms to be applied at specified stages to the sales price if the sale is ultimately consummated, but where the deposits are required to be accounted for by the seller and repaid to the buyer should the sale for any reason fail or be frustrated.

A strong decision in this line of cases is Consolidated-Hammer Film Co. v. C. I. R. (C. A. 7, 1963), 317 F. 2d 829. There advance deposit payments made by the government to a small manufacturer-seller undertaking to manufacture and sell a large, custom-ordered camera for government use were held to possess "[the] attributes of a financing arrangement in the nature of a loan", rather than to bear the indicia of advance sale partial payments; the deposits were accordingly held not taxable "[because] the proceeds of a loan do not constitute taxable income." (317 F. 2d at p. 832, emphasis added.)

In Summit Coal Co. v. C. I. R. (1930), 18 B. T. A. 983, a small coal mining company undertook to sell a very large amount of coal for delivery over a period of years at $5.50 per ton, and the seller was induced to advance $150,000 to the coal company to be used by it to expand its mine and facilities to facilitate the necessary production. The $150,000 was agreed to be repaid out of the coal delivered under the contract at the rate of a $1.00 credit per ton of coal delivered. Despite the fact that the coal company used the money immediately upon its receipt for expenditures for equipment, labor and modifications of its mining facilities, the Board of Tax Appeals found the payments were not "income" at the time of their receipt because it appeared "clear" "that the advances so made were in the nature of loans to be repaid by the deduction from subsequent payments of $1 for each ton of coal delivered to Matlack and Raleigh. These advances became income to petitioner only as and when recoupment was [actually] made from deliveries." (p. 988, emphasis added.)

To like effect, see also Bremerton-Tacoma Stages v. Squire (W. D. Wash., 1951), 96 F. Supp. 718, 721-723. 6/

6/ The Tax Court also cites Schlude v. Commissioner (1963), 372 U.S. 128; American Automobile Association v. United States (1961), 367 U.S. 687; and Automobile Club v. Commissioner (1957), 353 U.S. 180, but those decisions are without force or applicability at bar. In all of those decisions the monies paid to the taxpayer were advance payments certain to become income at fixed future dates and the only claim of the tax payer was that he should be allowed deferment of taxability until the date or period fixed for full or proportionate performance on his part, or for the right of the payor to demand such, so that income which was certain to occur should be recognized for tax purposes not when merely received physically but concurrently with the performance, or the right to

(Continued)

In cases involving advance deposit payments contingently subject to application as the payment in part or whole for the purchase of goods, a special feature makes it particularly inappropriate to attempt to treat such deposit payments as presently-taxable income to the seller. Not only is there involved in such a case the problem of the contingency of the sale as a general matter as discussed and treated above, but additionally where the deposit is contingently to be applied as constituting the part or whole purchase price of goods sold there arises the special complicating factor that the price to be received by the seller, or the cost to him of acquiring or producing such goods, or both such matters, may not yet be fixed or determined, or even determinable, and hence, also, the net gain or profit is not presently fixed nor even determinable. Under the Internal Revenue Act it is only gain or profit that is taxable as income, not simply gross receipts; in consequence, where the costs of goods and the sales price thereof, have not yet been fixed or agreed upon, it is particularly inappropriate to

---

6/ Continued: demand the performance, which would "earn" the same and create a true right to accrue or be paid such money as "earned income". At bar quite another issue is presented. Here the money is not received with a full and free claim of right to user, as in the Schlude, American Automobile Association and Automobile Club cases, but is received only in trust, or at least subject to a contract duty contingently to account for and pay back such payments received, and the money deposited was withdrawable by the applicant (in actual practice) at will, and even on the applicant's death the money would not go to petitioner if the applicant should have moved or journeyed to a place outside of Los Angeles County (a contingency of substantial proportions, and over which petitioner had no control or influence whatever) or should the relatives in any event desire burial by another funeral director and request transfer of the deposited funds to such other funeral director.

attempt to class any advance deposit payments under any such contracts as presently-taxable income payments to the seller. (Consolidated-Hammer Film Co. v. C. I. R., supra, 317 F.2d 829, 833; Veenstra & DeHaan Coal Co. (1948), 11 T. C. 964, 966-968; Woodlawn Park Cemetery Co. v. C. I. R. (1951), 16 T. C. 1067, 1079-1080.)

This principle is operative at bar since the funeral service ultimately to be performed by petitioner if an applicant died within Los Angeles County (and if the applicant had not earlier withdrawn the deposit payments and if the relatives after death did not request transfer of the payments to another funeral director), included by the terms of the deposit agreement a sale of a coffin of a retail value reasonably equal (when added to the other elements of the funeral service)to the amounts on deposit by the applicant at the time of death, or such greater amount as the relatives might agree upon after death. Thus the price to be received by petitioner in the contingent, future sale of such coffin was neither fixed nor determinable in advance, nor was the cost thereof to petitioner fixed or determinable; in consequence, the amount of gain (and hence, of taxable income) was neither known nor determinable in advance of death (Rep. Tr. p. 25, line 23 to p. 27, line 1; Petr's Ex. 10, par. 2 and Petr's Ex. 11, par. 2).

(c) Option Deposit Cases.

A final line of cases affording persuasive parallel authority confirming the non-taxable character of the deposit payments at

bar deals with option-deposit payments paid by a buyer for the allowance of an option but with the further provision that should the option be exercised during its life the option payment shall apply, either partly or in whole, against an agreed-upon purchase price. In such cases the original deposit payment cannot be classed as present taxable income to the seller. This because the nature and character of the payment is not known nor classifiable at the time of initial payment. If the option lapses without being exercised, the moneys deposited become at that moment ordinary income to the seller; if, on the other hand, the option is exercised during its life, the moneys originally received, so far as they are made applicable by the contract to satisfaction in part of the purchase price, become at that time payments on account of a sale, taxable only as to the gain realized, and even as to that perhaps taxable only as a capital gain, not as ordinary income. Accordingly, such deposit payments are so characterized by ambiguity and contingency at the time of their initial payment that they are not under law classifiable as present income to the seller. (Virginia Iron, Coal and Coke Co. v. C. I. R. (C. A. 4, 1938), 99 F.2d 919, 921-922; C. I. R. v. Dill Company (C. A. 3, 1961), 294 F.2d 291, 299-301; Kitchin v. C. I. R. (C. A. 4, 1965), 340 F.2d 895; 3B Mertens, Law of Federal Income Taxation, §22.29, pp. 193-194.) These decisions parallel the premises at bar and further confirm that the deposits paid under the 1961 agreement-form, which would never become income to petitioner should the applicant withdraw the deposits before death or die outside Los Angeles County or should

the relatives after death request transfer of the deposit funds to another funeral director, should not be classed in law as present income to petitioner at the time of payment and prior to the occurrence of the applicant's death.

CONCLUSION

WHEREFORE, upon all of the grounds and for all of the considerations set forth above, petitioner respectfully submits that the deposit payments received by petitioner under the 1961 agreement-forms, precisely like the deposits received under the earlier pre-1961 agreements, were not properly to be classified as "income" to petitioner at the time of first deposit, and taxable so, and that the portion of the Tax Court's decision below holding to the contrary should be reversed.

Under true law all of such deposit payments were either payments in trust or were deposits so characterized by contingency and by duty (continuing and overhanging albeit conditional) to account for and repay such deposited sums as to be akin or comparable in essential nature merely to loans or to option or security or contingency deposits, and under all such views or parallel classifications were -- under tax law fundamentals -- not taxable as "income" at the time of their first payment.

Respectfully submitted,

LEO BRANTON, JR. and
WILLIAM B. MURRISH

Attorneys for Petitioner

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ William B. Murrish
WILLIAM B. MURRISH

APPENDIX 1

Exhibits	For Identification	In Evidence
Stipulation of Facts and Joint Exhibits 1-A through 9-I	Rep. Tr. p. 17	17
Petr's Ex. 10	19	21
Petr's Ex. 11	20	21
Resp's Ex. J	35	